IDERA PHARMACEUTICALS, INC.
Form 10-Q
May 12, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2008,

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For transition period from _____.

Commission File Number: 001-31918

IDERA PHARMACEUTICALS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**04-3072298**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

167 Sidney Street
Cambridge, Massachusetts 02139
(Address of principal executive offices)

(617) 679-5500
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.) Yes o No þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common Stock, par value $.001 per share	**22,387,293**
Class	Outstanding as of April 30, 2008

IDERA PHARMACEUTICALS, INC.
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FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements, other than statements of historical fact, included or incorporated in this report regarding our strategy, future operations, collaborations, intellectual property, financial position, future revenues, projected costs, prospects, plans, and objectives of management are forward-looking statements. The words believes, anticipates, estimates, plans, expects, intends, may, could, should, potential, likely, projects, continue, will, and wo expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. We cannot guarantee that we actually will achieve the plans, intentions or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements. There are a number of important factors that could cause our actual results to differ materially from those indicated or implied by forward-looking statements. These important factors include those set forth below under Part II, Item 1A Risk Factors. These factors and the other cautionary statements made in this Quarterly Report on Form 10-Q should be read as being applicable to all related forward-looking statements whenever they appear in this Quarterly Report on Form 10-Q. In addition, any forward-looking statements represent our estimates only as of the date that this Quarterly Report on Form 10-Q is filed with the SEC and should not be relied upon as representing our estimates as of any subsequent date. We do not assume any obligation to update any forward-looking statements. We disclaim any intention or obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

IDERA PHARMACEUTICALS, INC.
CONDENSED BALANCE SHEETS
(UNAUDITED)

(in thousands, except per share amounts)	March 31, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 51,622	$ 12,588
Short-term investments	10,164	11,155
Receivables	483	628
Prepaid expenses and other current assets	737	656
Total current assets	63,006	25,027
Property and equipment, net	2,091	1,964
Non-current portion of prepaid expenses	104	104
Restricted cash	619	619
Total assets	$ 65,820	$ 27,714
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,404	$ 1,177
Accrued expenses	2,168	1,745
Current portion of capital lease	19	20
Current portion of note payable		266
Current portion of deferred revenue	22,726	5,911
Total current liabilities	26,317	9,119
Capital lease obligation, net of current portion	45	50
Note payable, net of current portion		877
Deferred revenue, net of current portion	28,804	9,874
Other liabilities	107	75
Total liabilities	55,273	19,995
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $0.01 par value,		
Authorized 5,000 shares		
Series A convertible preferred stock,		
Designated 1,500 shares,		
Issued and outstanding 1 share at March 31, 2008 and December 31, 2007		

Common stock, $0.001 par value, Authorized 40,000 shares Issued and outstanding 22,271 and 21,569 shares at March 31, 2008 and December 31, 2007, respectively	22	22
Additional paid-in capital	355,432	350,423
Accumulated deficit	(344,905)	(342,734)
Accumulated other comprehensive (loss) income	(2)	8
Total stockholders equity	10,547	7,719
Total liabilities and stockholders equity	$ 65,820	$ 27,714

The accompanying notes are an integral part of these financial statements.

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IDERA PHARMACEUTICALS, INC.
CONDENSED STATEMENTS OF OPERATIONS
(UNAUDITED)

(in thousands, except per share amounts)	Three Months Ended March 31, 2008	2007
Alliance revenue	$ 4,772	$ 1,829
Operating expenses:		
Research and development	4,534	2,819
General and administrative	2,416	1,953
Total operating expenses	6,950	4,772
Loss from operations	(2,178)	(2,943)
Other income (expense):		
Investment income, net	406	477
Interest expense	(82)	(62)
Foreign currency exchange loss	(267)	
Loss before income taxes	(2,121)	(2,528)
Income tax provision	(50)	
Net loss	$ (2,171)	$ (2,528)
Basic and diluted net loss per common share (Note 13)	$ (0.10)	$ (0.12)
Shares used in computing basic and diluted net loss per common share	21,899	20,787

The accompanying notes are an integral part of these financial statements.

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IDERA PHARMACEUTICALS, INC.
CONDENSED STATEMENTS OF CASH FLOWS
(UNAUDITED)

(in thousands)	Three Months Ended March 31, 2008	2007
Cash Flows From Operating Activities:		
Net loss	$ (2,171)	$ (2,528)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities -		
Gain on disposal of property and equipment		(3)
Stock-based compensation	659	345
Non-employee stock options	103	90
Depreciation and amortization	128	86
Issuance of common stock for services rendered	12	14
Changes in operating assets and liabilities -		
Accounts receivable	145	(174)
Prepaid expenses and other current assets	(81)	(49)
Accounts payable and accrued expenses	682	(88)
Deferred revenue	35,745	(1,693)
Net cash provided by (used in) operating activities	35,222	(4,000)
Cash Flows From Investing Activities:		
Purchase of available-for-sale securities	(7,071)	(26,206)
Proceeds from sale of available-for-sale securities		8,275
Proceeds from maturity of available-for-sale securities	8,045	1,500
Purchase of property and equipment	(249)	(874)
Net cash provided by (used in) investing activities	725	(17,305)
Cash Flow From Financing Activities:		
Proceeds from exercise of common stock options and warrants and employee stock purchases	4,236	192
Payments on note payable	(1,143)	
Payments on capital lease	(6)	(1)
Net cash provided by financing activities	3,087	191
Net increase (decrease) in cash and cash equivalents	39,034	(21,114)
Cash and cash equivalents, beginning of period	12,588	24,596
Cash and cash equivalents, end of period	$ 51,622	$ 3,482
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 82	$ 65

Cash paid for income taxes	$ 50	$ 45
Supplemental disclosure of non-cash financing and investing activities:		
Conversion of 4% convertible subordinated notes into common stock	$	$ 5,033

The accompanying notes are an integral part of these financial statements.

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IDERA PHARMACEUTICALS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS
MARCH 31, 2008
(UNAUDITED)

(1) (a) Organization

Idera Pharmaceuticals, Inc. (Idera or the Company) is a biotechnology company engaged in the discovery and development of DNA- and RNA-based drug candidates targeted to Toll-Like Receptors, or TLRs, to treat infectious diseases, autoimmune diseases, cancer, and asthma and allergies, and for use as vaccine adjuvants. Drug candidates are compounds that the Company is developing and have not been approved for any commercial use. TLRs are specific receptors present in immune system cells that recognize the DNA or RNA of pathogens such as bacteria or viruses and initiate an immune response. Relying on its expertise in DNA and RNA chemistry, the Company has designed and created proprietary TLR agonists and antagonists to modulate immune responses. A TLR agonist is a compound that stimulates an immune response through the targeted TLR. A TLR antagonist is a compound that blocks activation of an immune response through the targeted TLR.

The Company is focused on developing TLR-targeted compounds for the potential treatment of infectious diseases, autoimmune diseases, and cancer. IMO-2125, a TLR9 agonist, is the Company s lead drug candidate for infectious diseases. At present, a Phase 1 clinical trial of IMO-2125 is underway in patients with chronic hepatitis C virus infection who have not responded to current standard of care therapy. The Company s infectious disease program also includes evaluation of RNA-based compounds that act as agonists of TLR7 and TLR8. The Company has evaluated these compounds in preclinical studies in human cell-based assays and *in vivo* in non-human primates and intends to further evaluate these compounds in preclinical models of infectious disease. In the Company s autoimmune disease program, it has identified DNA-based compounds that act as antagonists of TLR7 and TLR9. These compounds have been evaluated in various preclinical studies, including in mouse models of lupus and rheumatoid arthritis. The Company is conducting further preclinical studies to explore the potential of these novel compounds in treating multiple sclerosis and psoriasis. The Company s cancer treatment research program is focused on potential applications of TLR7 and TLR8 agonists. The Company intends to further evaluate these compounds in preclinical models of cancer.

In addition, Idera is collaborating with three pharmaceutical companies to advance the Company s TLR-targeted compounds in multiple disease areas. The Company is collaborating with Merck KGaA for cancer treatment excluding cancer vaccines, with Merck & Co. Inc., for vaccine adjuvants, and with Novartis International Pharmaceutical, Ltd., or Novartis, for treatment of asthma and allergies. Merck KGaA and Merck & Co. are not related.

The Company has incurred operating losses in all fiscal years except 2002 and had an accumulated deficit of $344.9 million at March 31, 2008. The Company may incur substantial operating losses in future periods. The Company does not expect to generate significant funds internally until it successfully completes development and obtains marketing approval for products, either alone or in collaborations with third parties, which the Company expects will take a number of years. In order to commercialize its therapeutic products, the Company needs to address a number of technological challenges and to comply with comprehensive regulatory requirements.

(b) Recently Adopted Accounting Pronouncement

In July 2007, the Emerging Issues Task Force (EITF) issued EITF 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services to be Used in Future Research and Development Activities* (EITF 07-3). EITF 07-3 clarifies the accounting for nonrefundable advance payments for goods or services that will be used or

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rendered for research and development activities. EITF 07-3 states that such payments should be capitalized and recognized as an expense as the goods are delivered or the related services are performed. If an entity does not expect the goods to be delivered or the services rendered, the capitalized advance payment should be charged to expense. The Company adopted EITF 07-3 on January 1, 2008. The adoption of EITF 07-3 did not have a material effect on the Company s financial statements.

In December 2007, the EITF issued EITF 07-1, *Accounting for Collaborative ArrangementsRelated to the Development and Commercialization of Intellectual Property* (EITF 07-1). EITF 07-1 defines collaborative arrangements and establishes reporting and disclosure requirements for transactions between participants in a collaborative arrangement and between participants in the arrangement and third parties. EITF 07-1 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the effect of EITF 07-1 on its financial statements.

(2) Unaudited Interim Financial Statements

The accompanying unaudited financial statements included herein have been prepared by the Company in accordance with generally accepted accounting principles for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with United States generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation of interim period results have been included. The Company believes that its disclosures are adequate to make the information presented not misleading. Interim results for the three-month period ended March 31, 2008 are not necessarily indicative of results that may be expected for the year ended December 31, 2008. For further information, refer to the financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2007, which was filed with the Securities and Exchange Commission on March 11, 2008.

(3) (a) Cash Equivalents and Investments

The Company considers all highly liquid investments with maturities of 90 days or less when purchased to be cash equivalents. Cash and cash equivalents at March 31, 2008 and December 31, 2007 consisted of cash and money market funds.

The Company accounts for investments in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS No. 115). Management determines the appropriate classification of marketable securities at the time of purchase. In accordance with SFAS No. 115, investments that the Company does not have the positive intent to hold to maturity are classified as available-for-sale and reported at fair market value. Unrealized gains and losses associated with available-for-sale investments are recorded in Accumulated other comprehensive loss on the accompanying balance sheets. The amortization of premiums and accretion of discounts, and any realized gains and losses and declines in value judged to be other than temporary, and interest and dividends for all available-for-sale securities are included in Investment income, net on the accompanying statements of operations. The Company had no held-to-maturity investments, as defined by SFAS No. 115, at March 31, 2008 and December 31, 2007. The cost of securities sold is based on the specific identification method.

The Company had no realized gains or losses from available-for-sale securities for the three-months ended March 31, 2008 and 2007. There were no losses or permanent declines in value included in investment income, net for any securities in the three months ended March 31, 2008 and 2007.

The Company had no long-term investments as of March 31, 2008 and December 31, 2007. Available-for-sale securities are classified as short-term regardless of their maturity date as the Company considers them available for

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use to fund operations within one year of the balance sheet date. The Company s short-term available-for-sale investments at market value consisted of the following at March 31, 2008 and December 31, 2007:

(in thousands)	March 31, 2008	December 31, 2007
Certificates of deposit	$ 802	$ 2,801
Corporate bonds due in one year or less	3,026	1,653
Corporate bonds due in more than one year	1,005	
Corporate notes due in one year or less	2,023	
Corporate notes due in more than one year	1,005	
Government bonds due in one year or less	2,303	6,701
Total	$ 10,164	$ 11,155

(3) (b) Fair Values of Assets and Liabilities

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements, effective for financial statements issued for fiscal years beginning after November 15, 2007. SFAS No. 157 replaces multiple existing definitions of fair value with a single definition, establishes a consistent framework for measuring fair value and expands financial statement disclosures regarding fair value measurements. This Statement applies only to fair value measurements that already are required or permitted by other accounting standards and does not require any new fair value measurements. The adoption of SFAS No. 157 in the first quarter of 2008 did not have a material impact on the Company s financial position or results of operations.

In accordance with the provisions of SFAS No. 157, the Company measures fair value at the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Statement prioritizes the assumptions that market participants would use in pricing the asset or liability (the inputs) into a three-tier fair value hierarchy. This fair value hierarchy gives the highest priority (Level 1) to quoted prices in active markets for identical assets or liabilities and the lowest priority (Level 3) to unobservable inputs in which little or no market data exists, requiring companies to develop their own assumptions. Observable inputs that do not meet the criteria of Level 1, and include quoted prices for similar assets or liabilities in active markets or quoted prices for identical assets and liabilities in markets that are not active, are categorized as Level 2. Level 3 inputs are those that reflect the Company s estimates about the assumptions market participants would use in pricing the asset or liability, based on the best information available in the circumstances. Valuation techniques for assets and liabilities measured using Level 3 inputs may include unobservable inputs such as projections, estimates and management s interpretation of current market data. These unobservable Level 3 inputs are only utilized to the extent that observable inputs are not available or cost-effective to obtain.

The table below presents the assets and liabilities measured at fair value on a recurring basis at March 31, 2008 categorized by the level of inputs used in the valuation of each asset and liability.

	Quoted Prices in Active Markets for Identical Assets or Liabilities	Significant Other Observable Inputs	Significant Unobservable Inputs

(in thousands)	Total	(Level 1)	(Level 2)	(Level 3)
Assets				
Money market funds	$50,385	$ 50,385	$	$
Short-term investments	10,164		10,164	
Total	$60,549	$ 50,385	$ 10,164	$
Liabilities	$	$	$	$
Total	$	$	$	$

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The money market funds are classified as Level 1 since they are actively traded daily at $1.00 per share.

The fair value of short-term investments is generally determined from quoted market prices received from pricing services based upon quoted prices from active markets and/or other significant observable market transactions at fair value. Since these prices may not represent actual transactions of identical securities, they are classified as Level 2. Since all short-term investments are classified as available-for-sale securities, any gains or losses are recorded in other comprehensive gains or losses in the equity section of the balance sheet.

The Company also adopted the provisions of SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 in the first quarter of 2008. This Statement allows companies to choose to measure eligible assets and liabilities at fair value with changes in value recognized in earnings. Fair value treatment may be elected either upon initial recognition of an eligible asset or liability or, for an existing asset or liability, if an event triggers a new basis of accounting. The Company did not elect to re-measure any of its existing financial assets or liabilities under the provisions of this Statement.

(4) Property and Equipment

At March 31, 2008 and December 31, 2007, net property and equipment at cost consists of the following:

(in thousands)	March 31, 2008	December 31, 2007
Leasehold improvements	$ 432	$ 430
Laboratory equipment and other	2,832	2,585
Total property and equipment, at cost	3,264	3,015
Less: Accumulated depreciation and amortization	1,173	1,051
Property and equipment, net	$ 2,091	$ 1,964

As of March 31, 2008 and December 31, 2007, laboratory equipment and other includes approximately $98,000 of office equipment financed under a capital lease with accumulated depreciation of approximately $24,000 and $19,000, respectively. Depreciation expense, which includes amortization of assets recorded under capital leases, was approximately $122,000 and $66,000 for the three months ended March 31, 2008 and 2007, respectively. In the three months ended March 31, 2007, the Company sold and wrote off unused furniture and obsolete software, computers and other equipment that had an aggregate cost of approximately $49,000 resulting in a gain of approximately $3,000.

(5) Restricted Cash

As part of the operating lease entered into by the Company in October 2006, the Company was required to restrict $619,000 of cash for a security deposit. These funds are held in certificates of deposit securing a line of credit for the lessor. The restricted cash is expected to be reduced by approximately $103,000 upon each of the second, third and fourth anniversaries of the lease commencement date of June 2007, subject to certain conditions.

(6) Note Payable

In June 2007, the Company executed a promissory note in the aggregate principal amount of $1.3 million (the Note) in favor of General Electric Capital Corporation (GE). The Note was fully secured by specific laboratory, manufacturing, office and computer equipment and was subject to the terms of a master security agreement dated April 23, 2007 by and between the Company and GE. The Note bore interest at a fixed rate of 11% per annum, and

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was payable in 48 consecutive monthly installments of principal and accrued interest, with the first installment having been paid out of the proceeds of the borrowing.

In March 2008, the Company paid approximately $1,189,000 to General Electric Capital Corporation as payment in full of all obligations outstanding under the Company s Note with GE. The payment represented approximately $1,121,000 of principal amount outstanding plus accrued interest through the date of payment of approximately $12,000 and a prepayment premium of approximately $56,000. The Note was cancelled in March 2008.

(7) 4% Convertible Notes Payable

In May 2005, the Company sold approximately $5,033,000 in aggregate principal amount of 4% convertible subordinated notes that were due April 30, 2008 (the 4% Notes). In February 2007, the Company automatically converted these 4% Notes into 706,844 shares of the Company s common stock. In accordance with the terms of the 4% Notes and an agreement dated May 20, 2005, among the Company and the holders of the 4% Notes, the Company was entitled to exercise this right of automatic conversion because the volume-weighted average of the closing prices of the Company s common stock, for a period of ten consecutive trading days, exceeded $8.90 per share, which represented 125% of the conversion price of the 4% Notes. As of February 20, 2007, the 4% Notes were no longer considered outstanding and interest ceased to accrue. Holders of the 4% Notes were paid cash in lieu of any fractional shares and $61,000 in accrued interest through February 19, 2007.

The Company capitalized its financing costs associated with the sale of the 4% Notes and amortized them as interest expense through February 19, 2007. The unamortized balance of the deferred financing costs of $266,000 was reclassified to additional paid-in-capital in connection with the automatic conversion of the 4% Notes in the three months ended March 31, 2007.

(8) Comprehensive Loss

The following table includes the components of comprehensive loss for the three months ended March 31, 2008 and 2007.

(in thousands)	**March 31, 2008**	**March 31, 2007**
Net loss	$ (2,171)	$ (2,528)
Other comprehensive loss	(10)	(8)
Total comprehensive loss	$ (2,181)	$ (2,536)

Other comprehensive loss represents the net unrealized losses on available-for-sale investments.

(9) License Agreement with Merck KGaA

In December 2007, the Company entered into an exclusive, worldwide license agreement with Merck KGaA to research, develop and commercialize products containing the Company s TLR9 agonists for the treatment of cancer, excluding cancer vaccines, which agreement became effective February 4, 2008. Under the terms of the agreement, Idera granted Merck KGaA worldwide exclusive rights to its lead TLR9 agonists, IMO-2055 and IMO-2125, and to a specified number of novel, follow-on TLR9 agonists to be identified by Merck KGaA and the Company under a research collaboration, for use in the treatment, cure and/or delay of the onset or progression of cancer in humans. Under the terms of the agreement, in February 2008 Merck KGaA paid the Company a $40.0 million upfront license fee in Euros of which $39.7 million was received due to foreign currency exchange rates in effect at that time. The Company is recognizing the $40.0 million upfront payment paid under the collaboration as revenue over the expected period of the Company s continuing involvement. Merck KGaA also agreed to reimburse future development costs for certain of the Company s on-going IMO-2055 clinical trials, which will continue to be conducted by Idera; Merck KGaA agreed to pay up to EUR 264 million in development, regulatory approval, and commercial success milestone payments if products containing the Company s TLR9 agonist compounds are successfully developed and marketed

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for treatment, cure and/or delay of the onset or progression of cancer in humans; and Merck KGaA agreed to pay royalties on net sales of products containing our TLR9 agonists that are marketed.

(10) Collaboration and License Agreement with Novartis International Pharmaceutical, Ltd.

In May 2005, the Company entered into a research collaboration and option agreement and a separate license, development and commercialization agreement with Novartis to discover, develop and potentially commercialize TLR9 agonists that are identified as potential treatments for asthma and allergies. The Company and Novartis agreed that the term of the research and collaboration phase would be two years commencing in May 2005. The Company initially was recognizing the $4.0 million upfront payment paid under the collaboration as revenue over the two-year term of the research collaboration. In February 2007, Novartis elected to extend the research collaboration by an additional year. As a result of such extension, Novartis paid the Company an additional $1.0 million in May 2007. In March 2008, the Company agreed to extend the research collaboration until December 31, 2008. The extension is anticipated to allow for the advancement of QAX935, a novel agonist of TLR9, into human clinical trials prior to the end of the research collaboration term. The Company amortizes the upfront payment and the extension payment over the expected research term.

(11) Stock-Based Compensation

The Company accounts for share-based payments to employees under SFAS No. 123R, *Share-Based Payment*, (SFAS No. 123R). This statement requires the Company to recognize all share-based payments to employees in the financial statements based on their fair values. Under SFAS No. 123R, the Company is required to record compensation expense over an award s vesting period based on the award s fair value at the date of grant. The Company s policy is to charge the fair value of stock options as an expense on a straight-line basis over the vesting period. The Company included charges of $659,000 and $345,000 in its statements of operations for the three months ended March 31, 2008 and 2007, respectively, representing the stock compensation expense computed in accordance with SFAS No. 123R.

The Company s stock compensation plans include the 1995 Stock Option Plan, the 1995 Director Stock Option Plan, the 1995 Employee Stock Purchase Plan, the 1997 Stock Incentive Plan and the 2005 Stock Incentive Plan, all of which have been approved by the Company s stockholders. No additional options are being granted under the 1995 Stock Option Plan, the 1995 Director Stock Option Plan and the 1997 Stock Incentive Plan. In 2001, the Company also granted options to purchase shares of Common Stock pursuant to agreements that were not approved by stockholders.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option-pricing model and expensed over the requisite service period on a straight-line basis. The following assumptions apply to the options granted for the three months ended March 31, 2008 and 2007:

	Three Months Ended March 31,	
	2008	**2007**
Average risk free interest rate	3.3%	4.7%
Expected dividend yield		
Expected lives	5 years	6 years
Expected volatility	65.0%	70.6%
Weighted average grant date fair value of options granted during the period (per share)	$ 7.57	$ 4.91

The Company also awarded non-employee stock options to purchase 60,000 shares of common stock during the first quarter of 2008. These options had a Black-Scholes fair value of $710,000 at the time of grant based on a risk free interest rate of 3.9%, an expected life of 10 years, and an expected volatility of 95%. The fair value of the nonvested portion of the non-employee options will be remeasured each quarter in accordance with EITF No. 96-18, *Accounting for Equity Instruments That Are Issued to Other than Employees for Acquiring, or in Conjunction with*

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Selling, Goods or Services (EITF No. 96-18). Approximately $103,000 and $90,000 was recorded as an expense for non-employee stock options in the three months ended March 31, 2008 and 2007, respectively.

(12) Alternative Minimum Tax

Merck KGaA paid the Company in February 2008 a $40.0 million upfront license fee in Euros of which $39.7 million was received due to foreign currency exchange rates in effect at that time. As of March 31, 2008, the Company made an estimated quarterly tax payment of $50,000 as a result of this payment generating income subject to the alternative minimum tax or AMT. The Company did not have income subject to AMT for the three months ended March 31, 2007.

(13) Net Loss per Common Share

Basic and diluted net loss per common share is computed using the weighted average number of shares of common stock outstanding during the period. For the three months ended March 31, 2008 and 2007, diluted net loss per share of common stock is the same as basic net loss per share of common stock, as the effects of the Company s potential common stock equivalents are antidilutive. Total antidilutive securities were 6,976,663 and 7,475,086 for the three months ended March 31, 2008 and 2007, respectively, and consist of stock options, warrants and convertible preferred stock. Net loss applicable to common stockholders is the same as net loss for the three months ended March 31, 2008 and 2007.

(14) Warrant Redemption

In January 2008, the Company sent notice to holders of the Company s warrants to purchase common stock that were issued in August 2004 with an expiration date of August 27, 2009 (the August 2004 Warrants) that under the terms of the warrant agreement, it intended to redeem on March 31, 2008 any August 2004 Warrants not exercised as of that date for a redemption price of $0.08 per share of common stock underlying the August 2004 Warrants. The Company was entitled to exercise this redemption right because the closing price of the Company s common stock for twenty consecutive trading days ending December 20, 2007 was greater than $10.72 or 200% of the exercise price of the warrant. The August 2004 Warrants were exercisable by cash payment only and had an exercise price of $5.36 per share of common stock. Following such notice and through March 31, 2008, the Company received approximately $1,472,000 in proceeds from the exercise of August 2004 Warrants to purchase 274,650 shares of common stock. As of March 31, 2008, all August 2004 Warrants had been exercised.

(15) Related Party Transactions

During the three months ended March 31, 2008, the Company paid Dr. Robert W. Karr, a director of the Company, $47,000 for consulting services. The Company had no related party transactions in the three months ended March 31, 2007.

(16) Subsequent Event

In April 2008, the Company, under its collaboration agreement with Merck & Co., achieved a preclinical milestone with one of its novel TLR9 agonists used as an adjuvant in cancer vaccines. As a result, the Company is entitled to receive a $1.0 milestone payment from Merck & Co.

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ITEM 2. ***MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS***

GENERAL

We are engaged in the discovery and development of DNA- and RNA-based drug candidates targeted to Toll-Like Receptors, or TLRs, to treat infectious diseases, autoimmune diseases, cancer, and asthma and allergies, and for use as vaccine adjuvants. Drug candidates are compounds that we are developing and have not been approved for any commercial use. TLRs are specific receptors present in immune system cells that recognize the DNA or RNA of pathogens such as bacteria or viruses and initiate an immune response. Relying on our expertise in DNA and RNA chemistry, we have designed and created proprietary TLR agonists and antagonists to modulate immune responses. A TLR agonist is a compound that stimulates an immune response through the targeted TLR. A TLR antagonist is a compound that blocks activation of an immune response through the targeted TLR.

We are focused on developing TLR-targeted compounds for the potential treatment of infectious diseases, autoimmune diseases, and cancer. IMO-2125, a TLR9 agonist, is our lead drug candidate for infectious diseases. At present, we are conducting a Phase 1 clinical trial of IMO-2125 in patients with chronic hepatitis C virus infection who have not responded to current standard of care therapy. As part of our infectious disease program, we are also evaluating RNA-based compounds that act as agonists of TLR7 and TLR8. We have evaluated these compounds in preclinical studies in human cell-based assays and *in vivo* in non-human primates. We intend to further evaluate these compounds in preclinical models of infectious disease. In our autoimmune disease program, we have identified DNA-based compounds that act as antagonists of TLR7 and TLR9. We have evaluated these compounds in various preclinical studies, including in mouse models of lupus and rheumatoid arthritis. We are currently conducting further preclinical studies to explore the potential of these compounds in treating multiple sclerosis and psoriasis. Our cancer treatment research program is focused on potential applications of our TLR7 and TLR8 agonists. We intend to further evaluate these compounds in preclinical models of cancer.

In addition, we are collaborating with three pharmaceutical companies to advance our TLR-targeted compounds in multiple disease areas. We are collaborating with Merck KGaA to research, develop, and commercialize products containing our TLR9 agonists, including IMO-2055, for the treatment of cancer, excluding cancer vaccines. We are also collaborating with Merck & Co., Inc. for the use of our TLR7, 8 and 9 agonists in combination with Merck & Co. s therapeutic and prophylactic vaccines in the areas of oncology, infectious diseases, and Alzheimer s disease and with Novartis International Pharmaceutical, Ltd., for the discovery, development, and commercialization of our TLR9 agonists for the treatment of asthma and allergy indications. Merck KGaA and Merck & Co. are not related.

As of March 31, 2008, we had an accumulated deficit of $344.9 million. We may incur substantial operating losses in future periods. We do not expect to generate significant funds until we successfully complete development and obtain marketing approval for products, either alone or in collaborations with third parties, which we expect will take a number of years. In order to commercialize our products, we need to address a number of technological challenges and to comply with comprehensive regulatory requirements. In 2008, we expect that our research and development expenses will be higher than our research and development expenses in 2007 as we expand our IMO-2125 development program and accelerate our early-stage programs on TLR antagonists and on agonists of TLR7 and TLR8.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

This management s discussion and analysis of financial condition and results of operations is based on our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an

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ongoing basis, management evaluates its estimates and judgments, including those related to revenue recognition. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We regard an accounting estimate or assumption underlying our financial statements as a critical accounting estimate where (i) the nature of the estimate or assumption is material due to the level of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and (ii) the impact of the estimates and assumptions on financial condition or operating performance is material.

Our significant accounting policies are described in Note 2 of the Notes to Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2007. Not all of these significant accounting policies, however, fit the definition of critical accounting estimates. We believe that our accounting policies relating to revenue recognition and stock based compensation, as described under the caption Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies in our Annual Report on Form 10-K for the year ended December 31, 2007, fit the definition of critical accounting estimates and judgments.

RESULTS OF OPERATIONS

Three Months Ended March 31, 2008 and 2007

Revenue

Total alliance revenue increased by $2,943,000, or 161%, from $1,829,000 for the three months ended March 31, 2007 to $4,772,000 for the three months ended March 31, 2008. This increase was primarily due to $2,667,000 of license fees we recognized under our collaboration agreement with Merck KGaA, which became effective February 4, 2008. We are recognizing the $40.0 million upfront payment we received from Merck KGaA in February 2008 over the expected research term under the agreement. The increase is also attributable to reimbursed expenses of $103,000 related to conducting certain clinical trials under our collaboration agreement with Merck KGaA and increased reimbursed research costs of $301,000 under our collaboration agreement with Merck & Co. Revenue for both periods also includes $1,250,000 in license fee revenue recognized under our collaboration with Merck & Co. For the three months ended March 31, 2008, we recognized $309,000 in license fee revenue under our collaboration with Novartis compared to $297,000 recognized in the three months ended March 31, 2007.

Our revenues for both periods were comprised of revenue earned under various collaboration and licensing agreements for research and development, including reimbursement of internal and third-party expenses, and license fees, sublicense fees, and royalty payments.